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GLOBALIZATION IN FINANCIAL SERVICES — WHAT ROLE FOR GATS?

REMARKS OF CHANTAL THOMAS*

I commend Professor Malloy for undertaking this unique and quite relevant project. I found the survey on “Financial Services Trends in the Twenty-First Century” interesting for a number of reasons. Contemplating the survey results regarding the “Top Five Likely Trends” elicits some awe at the array of issues facing scholars and practitioners in financial services and related law.

The five trends — globalization, e-banking and technological change, consolidation of markets and regulation, consumer protection and privacy and safety and soundness — also interrelate in important ways. Since my charge, broadly speaking, is to discuss the “globalization” trend, I particularly want to point out how concerns related to the latter four trends become intensified and changed when viewed through the lens of the former. The increasing volume and complexity in international financial flows to which the term “globalization” refers¹ are significantly facilitated by e-banking and technological change; at the same time, these phenomena pose new challenges for those concerned with market consolidation, safety and soundness and consumer protection. Thus, globalization affects a wide range of other issues for financial markets and financial services.

There is no question that developments in the financial markets are both an indicator and a cause of more general economic globalization. To state a few statistics:

International bank lending increased almost sixteen-fold between 1970 and 1995. Worldwide foreign direct investment in the late 1990s achieved “seven times the level in real terms in the 1970s.” “Indirect” investment — the securities markets — grew even more remarkably. Worldwide annual short-term capital flows “now total more than \$2 trillion in gross terms, almost three times those in the 1980s.” Finally, trading in foreign currency has skyrocketed: the “daily turnover in foreign exchange markets increased from

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¹ For a definition of globalization, see Chantal Thomas, *Globalization and the Reproduction of Hierarchy*, 33 U.C. DAVIS L. REV. 1451, 1476–79 (2000).

around \$10–20 billion in the 1970s to \$1.5 trillion in 1998,” an increase of approximately one hundred fold.²

Needless to say, the expansion of financial services in banking and investment has made all of this possible. It is no surprise, accordingly, that the governments participating in the Uruguay Round of trade negotiations for the General Agreement on Tariffs and Trade (“GATT”)³ decided to forge an agreement establishing basic standards managing this important sector.⁴ The resulting General Agreement on Trade in Services (“GATS”)⁵ set forth general principles relating to both international services as a whole and financial services in particular.

Despite this apparently significant development, there seems to remain much indecision as to the ultimate import of the GATS for financial services, even in a globalized economy. For example, although Professor Malloy’s survey cites “globalization” as a leading trend in financial services, the GATS fails to elicit a consensus or even majority view. To the contrary, the response to the survey statements concerning the GATS was notably inconclusive. Survey statement number sixteen, for example, asked respondents to rate the assertion that “[t]he General Agreement on Trade in Services will become the dominant framework for the regulation of transnational financial services.” Twenty-two percent of those responding agreed with the statement, but twenty-two percent disagreed.⁶ The plurality —

² See *id.* at 1477 (footnotes omitted) (quoting U.N. DEVELOPMENT PROGRAMME, HUMAN DEVELOPMENT REPORT 1999: GLOBALIZATION WITH A HUMAN FACE at 25 (1999)).

³ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT].

⁴ The Uruguay Round of GATT trade negotiations was launched in 1986 in Punta del Este, Uruguay. GATT Ministerial Declaration on the Uruguay Round of Multilateral Trade Negotiations, Sept. 20, 1986, 25 I.L.M. 1623 (1986). The negotiations concluded in 1994 and resulted in the World Trade Organization (“WTO”). Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 1 (1994), 33 I.L.M. 1144 (1994). The WTO incorporates the older and more limited GATT by reference, but also adds a host of new agreements to the regulatory universe governing international trade. See generally *id.*

⁵ General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1B, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 28 (1994), 33 I.L.M. 44 (1994) [hereinafter GATS].

⁶ MICHAEL P. MALLOY, REPORT ON A SURVEY OF THE MEMBERSHIP OF THE AALS SECTION ON FINANCIAL INSTITUTIONS AND CONSUMER FINANCIAL SERVICES, *supra* p. 293.

thirty-four percent — neither agreed nor disagreed.⁷ Sixteen percent surveyed formally rejected any opinion whatsoever (the “no response” response) — more than twice the percentage in the same category for the non-GATS-related statements in the survey.⁸

All of this indicates a certain lack of clarity about the significance of the GATS to globalization in financial services. As it turns out, this inconclusiveness is at least partially well founded, since the GATS is in many ways still very much at a preliminary stage. Nonetheless, I thought it worthwhile to allocate my part in this discussion to an overview of the GATS, and a contemplation of what significance it might hold for the increasingly globalized terrain of financial services.

I will introduce this discussion by reviewing the importance of services to international trade. I will then take note of the challenges posed by incorporating international services into the international trade regime. Next I will highlight the elemental components of the GATS affecting financial services. Finally, I contemplate the international regulatory impact of the GATS in general, and the prospects for its expansion in upcoming WTO negotiations.

Economic Significance and Regulatory Challenges

The services sector can be defined as including all economic activity other than agriculture, manufacturing and mining.⁹ This is a very big tent, and it makes up the bulk of U.S. economic activity; approximately seventy-nine percent of U.S. private sector output.¹⁰ The same is true for many countries around the world, and is certainly true for industrialized countries. The United States is in fact the world’s largest services exporter.¹¹

⁷ *Id.*

⁸ *Id.*

⁹ Press Release, U.S. Commerce Department, International Trade Administration, Office of Service Industries, Services Exports and the U.S. Economy (Dec. 2001) [hereinafter *Services Exports*], available at <http://www.ita.doc.gov/td/sif/Charts12012001/0112Cover.htm>.

¹⁰ *Id.*

¹¹ Press Release, U.S. Commerce Department, International Trade Administration, Office of Service Industries, U.S. Global Services Exports (Dec. 2001) (indicating that, based on World Trade Organization estimates for global services trade in 2000, the U.S. accounts for nineteen percent of all global services exports), available at <http://www.ita.doc.gov/td/sif/Charts12012001/0112Page2.htm>.

Financial services themselves statistically constitute over seven percent of U.S. private services exports.¹² For a couple of reasons, I think this relatively small figure does not fully capture the significance of financial services. First, the current account does not reflect the volume of capital flows facilitated through the provision of financial services.¹³ Second, the way the U.S. government catalogs and quantifies services excludes any services provided through foreign direct investment. For example, financial services provided in other countries by U.S.-origin branches or subsidiaries would not be included in the current account measurement, though they constitute a significant part of the overall activity of international financial institutions and other services providers.¹⁴ Whatever the measurements employed, international services generally, and international financial services in particular, matter a great deal to the international market and to the United States as a major player in it. Indeed, the import of these services generated the momentum for the establishment of the GATS.

¹² See Press Release, U.S. Commerce Department, International Trade Administration, Office of Service Industries, Top Ten Services Exports, 2000 (Dec. 2001) [hereinafter Top Ten], available at <http://www.ita.doc.gov/td/sif/Charts12012001/0112T10.htm>. The major markets for U.S. services exports as a whole are the European Union countries (ninety billion dollars in 2000 exports of U.S. commercial services, or approximately thirty-two percent of total U.S. private services exports in 2000), Japan (thirty-four billion dollars in 2000 exports of U.S. commercial services, or approximately twelve percent of total U.S. private services exports in 2000) and Canada (twenty-three billion dollars in 2000 exports of U.S. commercial services, or approximately eight percent of total U.S. private services exports in 2000). Services Exports, *supra* note 9. See also Top Ten, *supra* (listing the statistics on total U.S. private services exports in 2000 that allowed for the calculation of the above listed percentages). Mexico is the largest of the emerging markets for U.S. services, with fourteen billion dollars in 2000 exports of U.S. commercial services, or approximately four percent of total U.S. private services exports in 2000. Services Exports, *supra* note 9. See also Top Ten, *supra* (listing the statistics on total U.S. private services exports in 2000 that allowed for the calculation of the above listed percentage).

¹³ For example, assume that a typical issuer of securities pays one percent of the value of the issuance in fees to the service providers (e.g., investment houses, law firms and accountants) that facilitate the issuance. If this is true, then the economic significance of those service providers, as handmaidens to the capital markets, would be far in excess of (at least 100-fold) their direct market value.

¹⁴ See Press Release, U.S. Commerce Department, International Trade Administration, Office of Service Industries, U.S. Services Exports and Foreign Sales of Services by U.S. Companies' Non-bank Majority Owned Foreign Affiliates, 1999 (1999), available at <http://www.ita.doc.gov/td/sif/Charts12012001/0112Combi.htm> (indicating that the export values of financial services generally exclude sales to affiliated parties).

Despite the significance of services in general and financial services in particular, regulatory challenges have impeded the expansion and implementation of an international agreement on trade in services. One of the main challenges is definitional. That is, because the term “services” casts such a broad net, it can be very hard to quantify what we mean by services. For example, it can be hard to distinguish services from investment. Since they often go hand-in-hand, measuring the two separately can be problematic. In addition, services and service transactions are often connected to the provision of goods (e.g., import distribution), and that can create challenges for pinning down definitions that are necessary to regulate trade in services. A more basic definitional problem is that of locating the service. For example, if I place a call from New Orleans to Mexico City, where is that service being provided — New Orleans, Mexico City, both or neither?

These are some of the empirical or definitional difficulties of establishing a regulatory framework for international trade in services. More important than the definitional challenges, however, are those that are normative or political in nature. Generally speaking, many trading partners of the United States, with the notable exception of the European Union, have resisted liberalization of trade in services, and have resisted accepting any significant international or supranational regulation of services. In particular, Japan and many developing countries have hesitated to offer up concessions in negotiations on trade in services.

Perhaps somewhat perversely, the reaction of the United States to this hesitation has posed another obstacle to international services regulation. On several occasions, the U.S. has blocked and delayed the conclusion of negotiations on services agreements, particularly in the financial services sector, on the grounds that other countries had not gone far enough in making concessions. For example, WTO members were unable to approve provisions on financial services at the establishment of the GATS in 1995 because the U.S. Trade Representative felt that other countries had not made large enough concessions.¹⁵

¹⁵ As a transitional matter, a second annex to the GATS, concerning financial services, permitted temporary withdrawal from commitments under the GATS. GATS art. XXIX, Second Annex on Financial Services, para. 2. It has been suggested that temporary withdrawal or modification was permitted in the second annex to allow for continued negotiation on market liberalization “because at the conclusion of the Uruguay Round, the United States was unsatisfied with other countries’ commitments. The United States was not willing to lock in its own liberal policies without reciprocal

Having noted the threshold issues involved in constructing an international regime for the regulation of services, I will now provide a brief overview of the ways in which the GATS has chosen to address them.

GATS Vocabulary

The GATS attempts to negotiate the definitional challenges mentioned above by establishing a four-part categorical framework laying out the scope of the agreement. The first of these categories is cross-border supply of services, that is, the "supply from the territory of one Member to the territory of another Member."¹⁶ Cross-border supply of services occurs, for example, when a consumer purchases insurance from a company located in a different country. "Consumption abroad" of services is the second category covered by the GATS. "Consumption abroad" is defined as a service supplied "in the territory of one Member to the service consumer of any other Member."¹⁷ An example of "consumption abroad" would be the purchase by an Argentinean of Treasury bonds while on holiday in New York.

"Commercial presence" services, which constitute a third category, basically refer to foreign direct investment.¹⁸ For example, a financial institution of one member can provide services in a foreign country through its commercial presence in the form of a branch or subsidiary. Finally, the fourth category includes those services provided through the "presence or movement of natural persons."¹⁹ For example, a

guarantees of full market access on a most-favored nation basis." Kristin Leigh Case, Recent Development, *The Daiwa Wake-Up Call: The Need for International Standards for Banking Supervision*, 26 GA. J. INT'L & COMP. L. 215, 220 n.32 (1996) (citing Joel P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 COLUM. J. TRANSNAT'L L. 37, 54 (1995)). The United States withdrew from the GATS transitional process with respect to the Agreement on Financial Services in June of 1995. See Paul Lewis, *Trade Accord without U.S. Set in Geneva*, N.Y. TIMES, July 27, 1995, at D1 (reporting on the U.S. refusal to join transitional arrangement). In July 1995, over eighty nations, including Japan, but not the United States, concluded a transitional agreement to liberalize international trade in financial services. *Id.* In advance of the 1997 expiration date of the transitional arrangement, however, the United States joined in the signing of a global accord to govern international trade in services. See Edmund L. Andrews, *Accord Is Reached To Lower Barriers in Global Finance*, N.Y. TIMES, Dec. 13, 1997, at A1 (discussing GATS accord).

¹⁶ GATS art. I, para. 2(a).

¹⁷ *Id.* art. I, para. 1(b).

¹⁸ *Id.* art. I, para. 2(c).

¹⁹ *Id.* art. I, para. 2(d).

securities firm provides services through the movement of natural persons by sending investment bankers to assist with underwriting local issues. Thus, this categorical framework is broad and attempts to eliminate the problem of distinguishing between foreign services and foreign investment by including investment as a form of services (i.e. the “commercial presence” category).

Substantive Commitments of the GATS

The GATS commits its members to a few central constraints on their regulation of international services: the obligations of most-favored-nation (“MFN”) treatment,²⁰ national treatment,²¹ market access²² and transparency.²³ Under the GATS, the MFN obligation operates through a negative list approach; i.e., a country must accord MFN status to other WTO members unless it has specifically listed an exemption for a particular services sector.²⁴ An exemption in this regard would specifically state that a nation was not going to grant MFN status in a particular area to another nation. In principle, exemptions are not to exceed 10 years, although there is no hard limit.²⁵ At the onset of the GATS, the United States requested a very broad exemption to allow it to deny MFN status when it thought a country had not sufficiently reciprocated U.S. liberalization commitments. The U.S. justified its broad exemption on the grounds that other WTO members had not gone far enough towards liberalizing trade in services.

By contrast, the national treatment and market access obligations take a positive list approach. A WTO member state has no obligation to grant either national treatment or market access to a foreign provider of a particular service unless it specifically lists the service sector. Market access is self-explanatory; the national treatment principle is simply that members may not discriminate against foreign service suppliers operating in a member’s domestic market. To activate these protections, a country must list a particular service sector in its schedule of commitments.

²⁰ *Id.* art. II.

²¹ *Id.* art. XVII.

²² *Id.* art. XVI.

²³ *Id.* art. III.

²⁴ *See id.* art. II.

²⁵ *Id.* art. XXIX, Annex On Article II Exemptions, para. 6.

The combination of the “negative list plus exemption” approach to the MFN rule and the “positive list” approach to the national treatment and market access rules means that the most important parts of the GATS are at the end of the framework agreement, where the lists of commitments for individual countries begin. The importance of these lists of specific commitments, when combined with the fact that several aspects of the GATS were negotiated in post-Uruguay Round agreements, means that the GATS can only be understood when considered in “loose-leaf” form, taking together all of its component documents. With respect to financial services, for example, relevant documents include the original framework agreement, exemptions, additional agreements that have been negotiated subsequently (e.g., the agreement on financial services) and schedules of specific commitments. There are other implementing agreements, such as the Annex on Financial Services, negative lists and layers of specific rules for financial services.

One of the most important documents for financial services, the Annex on Financial Services, authorizes each WTO member to establish prudential regulatory measures to protect purchasers and beneficiaries of financial services.²⁶ It also permits, but does not require, recognition of regulatory measures taken by WTO members. The decision by a member to recognize another country’s prudential measures may be undertaken independently by the member or may be the result of an agreement.²⁷ For example, the United States-Canadian Multijurisdictional Disclosure System provides that U.S. and Canadian securities regulators will reciprocally recognize securities registration statements prepared in accordance with the other nation’s domestic disclosure requirements.²⁸

Finally, the GATS applies the general dispute settlement processes contained in the WTO Dispute Settlement Understanding to disputes involving services.²⁹ Hence, one of the significant things about establishing the GATS was that it enabled WTO members that had

²⁶ *Id.* art. XXIX, Annex on Financial Services, para. 2.1.

²⁷ *Id.* art. XXIX, Annex on Financial Services, para. 3.1.

²⁸ Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 6902, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812, at 81,860 (July 1, 1991).

²⁹ The Annex on Financial Services mandates that panelists hearing disputes regarding “prudential issues and other financial matters” have specific expertise to enable them to render well-reasoned decisions. GATS art. XXIX, Annex on Financial Services, para. 4.1.

concerns in these areas to make use of the relatively strong dispute settlement procedures of the WTO. The GATS also established a Council for Trade in Services to address issues and to oversee consultations between members.³⁰

Regulatory Impact

What is the regulatory impact of the GATS in terms of prudential concerns; i.e., concerns about the basic safety and soundness of financial institutions?³¹ National treatment and market access are among the most important obligations under the GATS and they do not by themselves pose a threat to safety and soundness. The national treatment and market access obligations by themselves do not necessarily interfere with prudential goals, unless you are thinking about the broader interest of economic development or economic growth. Many developing countries have objected to providing market access that might interfere with their larger goal of self-sufficient economic growth.³² If we consider only questions of financial soundness, however, the current impact of the GATS is relatively minimal.³³ Quite simply, the drafters of the GATS knew that if they tried to push for more substantive regulations, they would not get them, and the achievement of any agreement on the subject might have been threatened. The GATS does not require harmonization or mutual recognition of prudential regulations, though such practices are permitted. Hence, the biggest impact of the GATS is in providing a framework for liberalization, because it establishes the obligations of market access and national treatment.

³⁰ *Id.* art. XXIV.

³¹ See generally Trachtman, *supra* note 15 (discussing this issue in greater detail).

³² This assertion takes a well-established position in the longstanding development policy debate. The argument here is that countries still in the throes of economic development must establish temporary protections to nurture “infant industries.” Trade protections, according to this argument, can be lifted only when a country has engaged in this preliminary capacity-building exercise and is therefore better prepared to face foreign competition. The other side of the debate, of course, states that such “inward-looking” policies are inherently incapable of breeding competitive industries, and that economic growth is significantly accelerated, rather than impeded, by attracting foreign investors.

³³ For example, the requirements of nondiscriminatory treatment do not prevent WTO member states from enforcing domestic regulations for “prudential reasons, including for the protection of . . . depositors . . . or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.” GATS art. XXIX, Annex on Financial Services, para. 2.1.

While virtually all of the members of the WTO maintain trade restrictions on the types of services described in the GATS, developing countries have relatively more work to do in conforming their regulations. Consider the extensive concessions that the People's Republic of China made in 2001 in connection with its accession to the WTO.³⁴ One can see very significant movement towards providing market access in financial services in a country that had no market access prior to its entry into the WTO. China has agreed to implement most of these commitments in the next five years. Thus, the impact of implementation of the GATS is rapidly increasing the globalization of financial services.

Conclusions and Prospects

Many issues remain unresolved within the GATS framework, and a broad agenda of negotiations is now underway.³⁵ Developing countries are pushing very hard for assistance in implementing the GATS. Transparency, of course, remains a big issue.³⁶ The relationship of the GATS to sub-central governments of WTO members is another concern. Finally, the status of e-finance under the GATS must be clarified.

As this brief overview of the GATS suggests, the agreement is still in the very early stages of development. Moreover, most of the regulatory pressure of the GATS will bear on poor countries, whose services sectors are much less developed, and where regimes for regulating services are less transparent and more restrictive than those found in the industrialized world. I have argued elsewhere that the

³⁴ A partial list of services concessions includes commitments on telecommunications (foreign service suppliers can establish joint venture enterprises, at the end of five years, maximum foreign ownership can be fifty percent on basic telecom and forty-nine on mobile services and there are no geographical restrictions); banking (foreign banks can provide foreign exchange services, non-bank financial institutions can provide auto-financing and at the end of five years there are no restrictions on the ability of foreign-owned banks to provide services); insurance (for life insurance, foreign companies can establish joint ventures with ownership of up to fifty percent, while for non-life insurance foreign companies can establish wholly-owned operations at the end of two years); securities (minority joint ventures can underwrite domestic issues); and travel (foreign-funded travel agencies can operate within five years).

³⁵ See WORLD TRADE ORGANIZATION, SERVICES: NEGOTIATIONS, at http://www.wto.org/english/tratop_e/serv_e/s_negs_e.htm (last visited Mar. 13, 2002) (containing an up-to-date status report and background on the negotiations).

³⁶ See GATS art. III, para. 1 (requiring publication and reporting of restrictive measures).

international economic order must incorporate concerns of equity in addition to efficiency.³⁷ The challenge for the ongoing GATS negotiations is to strike the appropriate balance in an increasingly important and complex arena.

³⁷ See Chantal Thomas, *Transfer of Technology in the Contemporary International Order*, 22 FORDHAM INT'L L.J. 2096, 2110–11 (1999).